

ORIGINAL **APS**



0000109385

RECEIVED

Leland R. Snook
Director
State Regulation & Pricing

Tel. 602-250-3730
Fax 602-250-3003
e-mail Leland.Snook@aps.com

2010 MAR 26 10:15

Mail Station 9708
PO Box 53999
Phoenix, Arizona 85072-3999

AZ CORP COMMISSION
DOCKET CONTROL

March 26, 2010

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

RE: Notice of Inquiry Regarding Utility Disincentives and Potential Decoupling for Arizona Utilities
Docket Nos. G-00000C-08-0314 and E-00000J-08-0314

Arizona Public Service Company ("APS") submits the following comments in response to Chairman Mayes' letter regarding utility disincentives and potential decoupling issued February 24, 2010 in the above-referenced matter.

If you have any questions regarding the information contained herein, please contact Zac Fryer at 602-250-4167.

Sincerely,

Leland R. Snook

LS/sl

Attachments

CC: Ernest Johnson
Steve Olea
Janice Alward
Rebecca Wilder
Lyn Farmer
Terri Ford
Barbara Keene
Parties of record

Arizona Corporation Commission
DOCKETED

MAR 26 2010



COPY of the foregoing delivered/mailed
this 26 day of March, 2010, to:

Lawrence V. Robertson, Jr.
P.O. Box 1488
Tubac, AZ 85646

Tim Hogan
Arizona Center for Law in the Public
Interest
202 East McDowell Road, Suite 153
Phoenix, AZ 85004

C. Webb Crockett
Patrick J. Black
Fennemore Craig
3003 North Central, Suite 2600
Phoenix, AZ 85012-2913

Jodi Jerich
Daniel Pozefsky
RUCO
1110 West Washington, Suite 220
Phoenix, AZ 85007

Michael A. Curtis
William P. Sullivan
Larry K. Udall
Curtis, Goodwin, Sullivan, Udall & Schwab, PLC
501 E. Thomas Road
Phoenix, AZ 85012-3205

Jay I Moyes
Karen Nally
Moyes Storey LTD
1850 N. Central Ave, Suite 1100
Phoenix, AZ 85004

Gary Yaquinto
President & CEO
Arizona Utility Investors Association
2100 N. Central Avenue, Suite 210
Phoenix, AZ 85004

Michael M. Grant
Gallagher & Kennedy, P.A.
2575 East Camelback Road
Phoenix, AZ 85016
Attorneys for AIC

Lyn A. Farmer
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Janice Alward
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Steve Olea
Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Michael Kurtz
Kurt J. Boehm
BOEHM, KURTZ & LOWRY
36 E. Seventh Street, Suite 2110
Cincinnati, OH 45202

Creden Huber
Sulphur Springs Valley Electric Cooperative,
Inc
P.O. Box 820
Wilcox, AZ 82311

Ladel Laub
Dixie-Escalante Rural Electric Association,
Inc
71 East Highway 56
Beryl, UT 84714-5197

Carl Albrecht
Garkane Energy Cooperative, Inc
P.O. Box 465
Loa, UT 84747

Jeffrey Woner
K.R. Saline & Associates, PLC
160 N. Pasadena, Suite 101
Mesa, AZ 85201

Richard Adkerson
Ajo Improvement Company
P.O. Drawer 9
Ajo, AZ 85321

Jack Shilling
Duncan Valley Electric Cooperative's Gas
Division
P.O. Box 440
Duncan, AZ 85534-0440

Dennis True
Morenci Water and Electric Company
P.O. Box 68
Morenci, AZ 85540

Douglas Mann
Semstream Arizona Propane, LLC
200 W. Longhorn
Payson, AZ 85541

Russ Barney
Graham County Utilities, Inc
P.O. Drawer B
Pima, AZ 85543

Gray Grim
Arizona Electric Power Cooperative, Inc
P.O. Box 670
Benson, AZ 85602

Caroline Gardiner
Trico Electric Cooperative, Inc
P.O. Box 930
Marana, AZ 85653

Paul O'Dair
Navopache Electric Cooperative Inc
1878 W. White Mtn Blvd
Lakeside, AZ 85929

Scott Canty
The Hopi Tribe
P.O. Box 123
Kykotsmovi, AZ 86039

Marcus Middleton
Copper Market, Inc.
P.O. Box 245
Bagdad, AZ 86321

Paul Griffes
Mohave Electric Cooperative, Inc
P.O. Box 1045
Bullhead City, AZ 86430

Michael Fletcher
Columbus Electric Cooperative, Inc
P.O. Box 631
Deming, New Mexico 88031

David Couture
UNS Electric, Inc
P.O. Box 711
MS UE201
Tucson, AZ 85702

Randy Sable
Southwest Gas Corporation
MS LVB-105
5241 Spring Mountain Road
Las Vegas, NV 89150

Justin Brown
Southwest Gas Corporation
MS LVA-120
5241 Spring Mountain Road
Las Vegas, NV 89150

Brooks Congdon
Southwest Gas Corporation
MS LVB-100
5241 Spring Mountain Road
Las Vegas, NV 89150

Laura Sanchez
NRDC
1500 Lomas Blvd. NW, Suite B
Albuquerque, NM 87104

John Wallace
GCSECA
120 North 44th Street, Suite 100
Phoenix, AZ 85034

Jeff Schlegel
SWEEP
1167 W. Samalayuca Drive
Tucson, AZ 85704

Mona Tierney-Loyd
EnerNOC, Inc.
P.O. Box 378
Cayucos, CA 93430

Michael W. Patten
ROSHKA, DeWULF, & PATTEN PLLC
One AZ Center
400 E. Van Buren, Suite 800
Phoenix, AZ 85012

Raymond Heyman
Unisource Energy
One S. Church, Suite 200
Tucson, AZ 85701

David Berry
Western Resources
P.O. Box 1064
Scottsdale, AZ 85252-1064

**Arizona Public Service Company Responses to Arizona Corporation Commission
Notice of Inquiry Regarding Utility Disincentives and Potential Decoupling for
Arizona Utilities: Docket Nos. G-00000C-08-0314 and E-00000J-08-0314**

Summary

In a letter docketed February 24, 2010, the Arizona Corporation Commission ("ACC") invited interested parties to provide responses to a Notice of Inquiry ("NOI") regarding utility disincentives and decoupling.

APS recognizes that the energy efficiency ("EE") and conservation programs developed to meet the Commission's EE requirements provide important customer and environmental benefits, including the potential for customers to reduce their electric bills and for a utility's supply-side resource needs to be delayed as a result of reduced consumption. APS fully supports the expansion of EE as a resource and as a lower cost alternative for helping to meet future energy demand requirements. However, successful energy efficiency programs – particularly at the aggressive levels set by the Commission in its recent EE rulemaking – create significant financial issues for the utility. In order for APS to avoid being financially harmed by meeting the aggressive EE standard, it is essential to better align the company's business model with the public interest through a method such as decoupling.

Under traditional ratemaking, the vast majority of a utility's fixed costs are collected through usage-based (or "volumetric") rates. EE programs are designed to reduce customer consumption and thus will reduce kilowatt hour sales ("kWh"). Without offsetting compensation, the reduced sales prevent the utility from fully collecting its fixed cost, therefore depriving the utility of a reasonable opportunity to earn its allowed return. If a utility is to implement EE programs designed to meet the state's requirements, it needs a corresponding mechanism to support the financial needs of the utility.

To promote the robust success of EE, APS supports adopting a decoupling mechanism as a means of balancing the important benefits that EE provides with the utility's ability to collect its fixed costs and opportunity to earn its allowed return. A fixed cost revenue per customer decoupling model best provides this balance.

Responses to the NOI

1. What financial disincentives to utilities are created by the implementation of energy efficiency measures?

The successful implementation of energy efficiency measures has an adverse financial impact on Arizona utilities that, if not resolved, prevents the utility from having the reasonable opportunity to earn its authorized rate of return. This presents a powerful disincentive for investment in energy efficiency programs.

Generally speaking, a utility has two types of costs: fixed and variable. Variable costs are those that change depending on the amount of energy produced, such as fuel costs. Fixed costs are those that do not fluctuate with the amount of energy produced and consumed, such as carrying costs and taxes associated with generation, transmission and distribution facilities and general plant, among others. Under traditional ratemaking, the vast majority of each of these costs is collected through usage-based (or "volumetric") rates. Currently, APS collects only about 16% of its fixed costs through a fixed charge (the basic service charge), while most of the remaining 84% is collected through kWh rates. Under this rate design, the revenue a utility needs to recover the vast majority of its fixed costs entirely depends upon selling kilowatt hours ("kWh"). The more kWh a utility sells, the more revenue a utility can collect and the greater the portion of its fixed costs are recovered. Conversely, the lower the kWh sales, the less likely the utility will be able to recover even most of its fixed costs of service.

EE programs are designed to reduce consumption and thus will reduce kWh sales, whether in absolute terms or relative to what sales would have been in the absence of EE programming. Without offsetting compensation, the reduced sales prevent the utility from bringing in the revenue needed to fully recover the cost of service set by the Commission in the utility's last rate case and thus deprive it of a reasonable opportunity to earn its allowed return. The under-recovery of the utility's fixed costs thus contributes to earnings erosion and deteriorating financial metrics, an effect that is compounded over time due to inflation in the price of materials and supplies and other unavoidable operational cost pressures.

Chairman Mayes addressed the importance of the cost-recovery issue associated with EE programming in the recent EE Rulemaking proceeding (Docket No. RE-00000C-09-0427), stating that:

"I'm 99 percent sure that you will not find a state in this country that established an energy-efficiency standard as aggressive as this one but doesn't also have either decoupling or some kind of mechanism designed to help recover some of these costs or have done that

closely after having adopted the standard. I mean...there is a sort of tipping point where...after you get beyond a certain point of energy efficiency...there is an expectation that commissions should address this issue." (See EE Rulemaking transcript at 114).

APS agrees. If a utility is to implement EE programs to help reduce sales, it needs a corresponding mechanism in place to help recover the fixed costs that a utility incurs to safely and reliably serve its customers that will otherwise be lost.

2. *Should the Commission consider a decoupling or decoupling-like mechanism that would allow Companies to recover weather-adjusted fixed costs that are lost as a result of energy efficiency programs that drive conservation? If so, why?*

Yes. Arizona is set to implement one of the most ambitious EE standards in the United States by establishing a 22% reduction in sales from EE by 2020. Such an aggressive standard requires an equally aggressive decoupling mechanism. In the EE Rulemaking proceeding, Jeff Schlegel on behalf of Southwest Energy Efficiency Project ("SWEEP") stated that utilities "should have the opportunity to recover prudently incurred fixed costs and recover any unrecovered or under-recovered fixed costs" (see EE Rulemaking transcript at 106). Currently, the vast majority of APS's costs are collected through volumetric rates, meaning the more a customer conserves, the less fixed cost recovery a utility receives. In fact, in the recent APS Settlement Agreement hearings (Docket No. E-01345A-08-0172), APS witness Jim Wontor stated that the 3.75% EE target that was established in the rate case, would result in over \$100 million in uncollected fixed costs from 2010 – 2012 (see Wontor Hearing Testimony at 1668). This 3.75% EE goal will result in a substantial amount of lost revenues, let alone a 22% EE goal.

It is essential to APS that a mechanism to address the disincentive associated with EE and allow for full cost recovery be established. As mentioned in response to Question 1, without some mechanism to address the disincentive associated with EE, utilities will be financially penalized for implementing effective EE programs which could potentially lead to more frequent rate cases.

3. *If you believe the Commission should adopt such a mechanism, how should it be structured?*

APS supports a fixed cost revenue per customer decoupling model, where fixed costs are comprised of non-transmission facilities (APS does not intend to include fixed costs associated with transmission, since the Company has a transmission formula rate and corresponding retail Transmission Cost Adjustor in place), to address the disincentives of EE for the following reasons:

- It is the most commonly applied form of decoupling within the utility industry;
- It removes the link between volumetric sales and revenue collection, thus eliminating the disincentive associated with implementing EE programs;
- It allows a utility to collect the fixed costs of service (as determined within a rate case) associated with both existing and future customers.

To determine fixed cost revenue per customer decoupling, the authorized fixed cost revenue level as determined within a rate case is divided by the number of customers in the Test Year to determine the appropriate revenue per customer collection. This calculation can be made on a system-wide or segregated customer class basis. Annually, the company would apply the authorized revenue per customer charge against the new customer base to determine the necessary recovery (the new customer base can be calculated using the previous year customer base or the upcoming year anticipated customer base). This amount would be compared to what was actually collected and the difference would result in a true-up adjustment, to be collected in the following calendar year. The adjustor would be implemented through a kWh or kW surcharge on customer bills.

a. Should certain customer classifications be exempt?

All major customer classes should be included in the decoupling mechanism, as each of the classes benefit from EE programs.

4. How should weather-related changes in customer usage be treated? Should they be excluded and if so, how?

A weather normalization adjustment is a reasonable means of addressing any unusual fluctuations in weather year over year. For consistency purposes, such an adjustment should align with whatever reasonable methodology is used in the utility's rate cases. For APS, for example, any weather-normalization adjustment for decoupling should be based on the same historical 10-year average used and accepted in the Company's past several rate cases.

5. What mechanism should be used for recovery of unrecovered fixed costs associated with energy efficiency? What are your views of utilizing a deferral mechanism but requiring that accumulated costs be amortized over several years, if deferrals were large?

Please see response to Question 3, in which APS proposes a fixed cost revenue per customer decoupling mechanism to recover uncollected fixed costs associated with EE.

With respect to a deferral mechanism, the device alone without an annual adjustment would not adequately address the disincentives associated with EE and would result in larger and more sporadic increases in customer bills – an unfavorable result. For example, if a utility is to defer all costs associated with EE between rate cases, that could result in a substantial increase in customer's bills when new rates go into effect, as you would not only increase base rates, but you would also include the adjustment for the uncollected fixed costs accumulated during the preceding years.

Furthermore, a deferral is subject to Generally Accepted Accounting Principles ("GAAP") rules which likely will result in financial and recording constraints, in which a utility could potentially be unable to collect the allowed revenue requirement. Therefore, a deferral would not be as good an option to address uncollected fixed costs. Instead, as stated in response to Question 3, a fixed cost revenue per customer decoupling mechanism with an annual true-up would allow for more concurrent recovery and to smooth out the adjustments in customer bills – providing the appropriate price signal to customers associated with EE.

- a. *If the Commission was to adopt decoupling and use a deferral mechanism, how should usage related to new customer additions be treated during the deferral period, i.e. should it be excluded or included?*

As stated in response to Question 3, APS supports a fixed cost revenue per customer approach, as each customer is assigned a fixed cost that a utility must incur to safely and reliably serve said customer. Customer growth is still expected to occur in Arizona, with the attendant increases in costs to serve these new customers, and the decoupling mechanism proposed is intended to capture these additional fixed costs (at the allowed per-customer Test Year level) associated with growing customer base.

- b. *Should both programmatic and non-programmatic energy savings be included in the deferrals? If so, how should non-programmatic energy savings be measured and verified?*

The fixed cost revenue per customer decoupling mechanism proposed by APS in response to Question 3 includes both programmatic (i.e. utility sponsored EE programs) and non-programmatic (i.e. reductions in sales not attributed to utility

sponsored EE programs) energy savings. Non-programmatic energy savings should count towards the annual decoupling calculation, as those are tangible savings. In APS's case, since the vast majority of costs are collected through volumetric rates, the Company would not receive the amount of fixed costs authorized in its rate case due to the reduced consumption from both programmatic and non-programmatic measures.

6. *What features can be adopted as part of a decoupling proposal that would prevent the Company from over-earning, and address concerns that decoupling proposals necessarily mean deviating from the "matching principle"?*

The possibility that APS will over-earn its allowed rate of return in the near future is remote. Even if rapid customer growth were to return, the increased revenue that would result from additional customer sales would be surpassed by the consequential capital investment required to support that growth. In addition, a decoupling mechanism does not deviate from the "matching principle." Rather it would more accurately align costs incurred by a utility to the price a customer ultimately pays.

- a. *Should the Commission consider a "cap on earnings" as part of its approval of a decoupling plan?*

A "cap on earnings" would need to be evaluated within the context of each individual decoupling proposal, as the mechanism and actual collection could vary and accordingly the earnings cap proposal may also need to vary. Additionally, if a cap was approved, a bandwidth would be an appropriate measure to include, so a utility could have flexibility from year to year to allow for normal fluctuations.

- b. *Should a lower Return on Equity be adopted when considering rate cases for decoupled Companies to recognize that such companies may incur less risk compared to non-decoupled companies?*

Whether or not a utility has a decoupling mechanism or other device in place that allows it to recover what would otherwise be unrecovered fixed costs is one of several factors that should be considered in the risk analysis undertaken when determining a Company's allowed return on equity. While implementing a decoupling mechanism will help a utility maintain a sustained level of earnings between rate cases, it does not remove all or even most risk and should not in itself require that the allowed ROE be lowered by any predetermined amount. To the contrary, perfunctorily lowering the authorized ROE simply because a decoupling mechanism is adopted to compensate the utility for what would otherwise be unrecovered costs merely exchanges one disincentive for another.

In APS's case, the overall risk analysis would not likely change materially if the Commission were to implement a decoupling mechanism. The Company's current authorized ROE is premised on certain energy efficiency presumptions. To the extent APS invests more heavily in energy efficiency programs to meet its rising energy efficiency targets, the corresponding increased sales reduction will exacerbate APS's current under-recovery. This result heightens the risk to investors that APS will not perform well financially, potentially meriting a higher authorized ROE in the Company's next rate case. A decoupling mechanism would offset that otherwise increased risk, meaning that the ROE should remain at least at its current level. In fact, APS's peer group (those utilities to which APS is compared in the risk analysis) consists of several utilities that *both* have decoupling *and* an ROE at or in excess of what was recently authorized for APS.

More fundamentally, APS's actual earned return is likely to be less than its authorized 11% over the next two years. A decoupling mechanism will not correct this deficiency, but should avoid having that return fall even further from allowed levels as a result of EE programs.

- c. Should the Commission require that Companies' decoupling mechanisms and deferrals be reviewed after some period of time, i.e., after three years of operation, unless the Company comes in for a rate case sooner?*

With the implementation of a decoupling mechanism, Commission Staff would have the ability to review the annual adjustment calculation and supporting details with the new rate implementation, but it would also be appropriate to have it reviewed within a rate case. If a utility does not frequently come in for rate cases, the Commission always has the authority to request a "show cause" for any utility to evaluate its cost structure and return. In the case of APS, the Settlement sets forth a rate case cycle in which the Company must file two rate cases in the next five years. Therefore, if the Commission implements a decoupling mechanism in APS's 2010 Test Year rate case, the Commission would have the opportunity to review and analyze the mechanism within APS's second rate case to be filed in 2013.

- 7. Please state whether the information provided in the Revenue Decoupling Data Report filed in compliance with Decision No. 70665 supports or argues against revenue decoupling in the case of natural gas companies.*

Not applicable to APS.

8. *What disincentives to customer conservation may be caused by virtue of the adoption of decoupling or decoupling-like mechanisms?*

A decoupling mechanism removes the disincentive for a utility to implement effective EE programs. Effectively implementing and marketing these programs, could actually drive more customer participation in EE programs, which would provide additional benefits to the customer. Further, if the customer has a lower level of consumption, other volumetric portions of a customer's bill, such as variable fuel costs, will be correspondingly lower, resulting in a reduced bill. Also, even with the implementation of a decoupling mechanism, EE programs still cost less than traditional supply-side resources, providing a benefit to customers in the event that a resource can be deferred due to EE program implementation.

A decoupling mechanism is designed to collect fixed costs in which a utility is not recovering due to EE, so implementing a mechanism would not result in a disincentive to the customer to conserve, it would actually more accurately align the cost to serve the customer with the price they pay.

9. *Are price signals to consumers skewed by decoupling, and if so, how?*

No, price signals are improved compared to what they are today, as a decoupling mechanism would actually better align a utility's costs with the price customers pay, sending the correct price signal. The goal of decoupling is to separate volumetric sales from revenues to allow a utility the opportunity to collect the established revenue requirement as determined within a rate case. A decoupling mechanism allows a utility to recover fixed costs that otherwise would be collected, under traditional ratemaking, through a volumetric kWh charge, which potentially results in revenue erosion due to decreasing sales. Additionally, the decoupling calculation is based on the most recent rate case, therefore if costs are not adequately established and aligned within the rate case, the price signals will be skewed regardless of the decoupling mechanism.

10. *What type of revenue decoupling mechanism is appropriate for Arizona or does it vary by company and with different facts?*

- a. *Revenue per Customer?*
- b. *Sales margin per Customer?*
- c. *Total margin revenue?*
- d. *Total class revenue?*
- e. *Usage per customer?*

The appropriate decoupling mechanism for any one utility could vary, depending on kWh usage and customer growth characteristics. To define specific decoupling mechanisms, APS believes that there are two major categories in

which decoupling adjustments can be categorized: revenue per customer decoupling and full revenue decoupling.

A fixed cost revenue per customer decoupling approach, which is supported by APS, as stated in response to Question 3, takes the fixed cost revenue requirement established in a rate case and divides that by the customer base to determine a fixed cost revenue per customer amount. Annually, the utility would take that per customer amount and multiply it by the new customer base to establish the allowed recovery. The difference between the amount collected and amount allowed would be the annual adjustor. This mechanism is the most commonly used within the utility industry.

Sales margin per customer decoupling is the same adjustment as fixed cost revenue decoupling, as "sales margin" is defined as total revenues less fuel, which is the same subset of costs in which APS proposes to include in the fixed cost revenue per customer adjustment (as previously stated, transmission would also be excluded from any decoupling calculation, since the Company has a transmission formula rate in place). A fixed cost revenue per customer decoupling approach is a favorable mechanism as it assigns each customer a fixed cost based on the rate case cost of service and it distinctly removes the link between volumetric sales and revenue collection. For further benefits of this mechanism, please see the response to Question 3.

A full revenue decoupling mechanism takes the authorized revenue requirement as established in the most recent rate case and breaks out the revenue requirement by customer class (i.e. residential, small commercial and industrial, larger commercial and industrial, etc.) – this would be the annual amount in which a utility would be allowed to collect. The annual adjustment would be the difference between the collected class revenue and the authorized class revenue. "Total class revenue decoupling" is similar to that of full revenue decoupling, as it typically is established on a class by class basis. A full revenue decoupling mechanism does not take into account customer growth and in an environment like Arizona's, which has historically had in excess of 3% annual customer growth rates and is expecting to experience this level of growth again in the future, this mechanism would result in penalizing a utility for customer growth.

A "usage per customer" (otherwise termed a "lost revenue adjustment") may be an alternative option to address the disincentives associated with EE. To calculate this adjustment, a utility would take the average sales reduction due to EE by customer class and apply the fixed cost rate as established in the most recent rate case cost of service study to determine the annual adjustment. This mechanism uses a narrow scope to address the effects of EE and it would concentrate on those reduced sales.

11. Should the Commission impose penalties for failure to meet specific designated DSM goals?

No. The issue of penalties was addressed in the Commission's draft EE rules and it was ultimately decided that a penalty was not appropriate. Further, the goal of the tiered performance incentive portion of the Demand Side Management Adjustment Clause ("DSMAC") is specifically aimed at providing the Company with an incentive for achieving EE targets. Correspondingly, if a utility does not meet at least 85% of the performance goals no incentive will be allowed. If the Commission deems that the costs a utility incurs to implement EE programs are not prudent, they can disallow a portion of the costs. If, however, a utility is striving to initiate cost beneficial EE programs and market them to customers, yet the customers are not adopting the programs, resulting in minimally acceptable participation levels, rather than over-achieving the important EE goals, the Company should not be penalized for lack of participation.

a. Should the opportunity to have periodic rate adjustments be tied to meeting specific energy efficiency requirements?

Meeting specific energy efficiency requirements would be more appropriately addressed in the DSMAC implementation plan, as program effectiveness and customer adoption is an EE program issue, not a decoupling issue. A decoupling mechanism is designed to remove the disincentive to implement EE programs, however, even if the stated EE goals are only minimally met, a utility is still experiencing under-recovery of fixed costs and should accordingly be allowed to recover those costs.

12. What means should be employed to track conservation associated with specific DSM programs for purposes of evaluating the success of decoupling?

DSM program conservation should not be used as a method in which to evaluate the "success of decoupling." The success of decoupling should be determined by a utility's willingness to invest in cost effective EE programs. Typically under traditional rate making, the vast majority of a utility's costs are collected through volumetric rates and effectively implementing EE programs would result in reduced revenue collection. Thus, if a utility is readily promoting and implementing EE programs and is remaining financially whole, a decoupling mechanism would be successful.

13. What mechanisms are needed to assure data quality and accuracy of forecasting customers, usage and utility driven energy efficiency savings?

Decoupling mechanisms can use a historical look at actual data to determine the correct annual true-up adjustment or it can use forecast data. If forecast data is used, an annual true-up would be used to align the forecast with actual data.

14. Should decoupling mechanisms include a low-income component?

If this question is asking whether low-income customers should be exempt from a decoupling mechanism, the Commission needs to evaluate the current subsidies that are given to low income customers and their participation in EE programs. Currently, low income customers are given a sizable discount on their bills, in addition to the various rate and adjusters exclusions, such as the DSMAC, the Power Supply Adjustor and the most recent APS rate case increase. In regard to low income customer program availability, a significant subset of the current EE programs are targeted toward helping these customers reduce their consumption. Therefore, the Commission should evaluate low income customers and the subsidies they are currently afforded and determine if excluding them from a decoupling mechanism is appropriate.

a. Should utility energy-efficiency programs be structured to align costs and benefits among rate classifications?

The purpose of a decoupling mechanism is to remove the disincentive to implement EE programs, not to align EE program costs and benefits. Nevertheless, the APS-supported fixed cost revenue per customer mechanism calculates fixed costs with each customer class – establishing a correct cost recovery alignment.

However, if this question is asking whether EE program spending should be structured to align the costs and the benefits of these programs among customer classes, a utility's EE programs should be structured to best meet the energy saving needs and desires of its customers, not to align with how the costs of those programs are collected. Additionally, if the Commission would like to further address this issue, it would be appropriate to do so within the annual DSM implementation plan.

15. What additional issues should the Commission consider when addressing utility disincentives to implementing its Energy Efficiency?

APS believes that the following question should be addressed in the consideration of a decoupling mechanism.

Are there any other programs in which a utility participates that cause uncollected fixed costs?

Yes. Distributed generation ("DG") also creates uncollected fixed costs implications for a utility. The Arizona Administrative Code requires APS to obtain 15% of generation from renewable resources by 2025, of which 20% of renewables in 2010, 25% in 2011 and 30% of renewables resources thereafter are to be obtained from DG resources. Due to these standards, renewable energy is rapidly becoming a large component of APS's resource mix and the DG portfolio will also be steadily increasing, resulting in a loss of fixed cost recovery for a utility. Indeed, APS actually markets DG in conjunction with EE to customers because both lead to precisely the same result – lower kWh purchases from APS.

In the case of DG, a utility still needs to hook-up a customer to the electrical system to support the needs of that customer. This requires a utility to invest in the same infrastructure, ranging from a meter, meter reading, to the distribution system, substations, etc. that would need to be installed regardless of whether the customer has DG. Also, in the event a customer's DG system becomes inoperable or decides to not use the system, a utility is required to serve each customer within its services territory and therefore needs to appropriately size its system to handle any necessary capacity that may arise and also have any applicable replacement or supplemental power required available. Therefore, APS also proposes that any decoupling mechanism include those unrecovered fixed costs associated with DG.